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Pensions & Investments

The Newspaper of Corporate and Institutional Investing

$9 An Issue $135 A Year

AT DEADLINE

TSA Capital could be sold

Trust Services of America, which owns TSA Capital Management, could be up for sale.

Richard Boling, a senior vice president at TSA Capital, confirmed there is a list of bidders, but an official of Cal Fed — the savings and loan parent of both firms — said there's been no official word of a planned sale.

Meanwhile, the International Paper pension fund dropped TSA Capital as an equity manager.

Nomura Capital on probation

The $66 billion California Public Employees' Retirement System put Nomura Capital Management on probation last week. The action took place following revelations that Nomura's parent company had compensated some of its leading clients for investment losses.

Nomura Capital managed about $500 million for the fund in international equities.

Funds reveal hirings

The $170 million **Intermountain Health Care** pension fund hired Burgess Capital to manage $17 million in international equities. . . . The $250 million **Illinois Power** pension fund placed $5 million with Parvest International, a venture capital fund. . . . Fairfax County, Va., hired Bank of New York as master custodian for the **Supplemental Retirement**, **Fairfax County Uniformed Retirement** and **Fairfax County Police Officers Retirement** systems, with combined assets of $925 million. . . . The **PBGC**, in restructuring its $4 billion-plus portfolio, allocated $100 million in active equity accounts to Newbold's Asset Management, Fayez Sarofim and Lehman Ark Management.

INSIDE

MICHAEL A. MANCOTTE

Savings plan on track

G.E. Rail Car Services set up 401(k) plans for employees at its 12 non-union plants nationwide — including this one in Chicago Heights, Ill. — after management decided it wanted to encourage personal savings. Page 19.

Pan Am termination is probable

PBGC, Delta vie for shuttle assets

By Joel Chernoff

WASHINGTON — After years of struggling, Pan Am Corp. is likely to jettison some $840 million in unfunded pension liabilities onto the Pension Benefit Guaranty Corp.

The likely demise of the airline and termination of its pension plans has pitted the pension agency against Delta Air Lines Inc. and other creditors of Pan Am over the assets of the Pan Am shuttle.

The termination of New York-based Pan Am's pension plans "is probably inevitable at some point," given reported statements by the airline that it plans to pursue an orderly liquidation and assuming Pan Am completes its plan to sell off its major assets, a PBGC spokeswoman said.

That might cause the agency to absorb its largest loss ever, excluding losses from The LTV Corp. plans that subsequently were restored to the company. The PBGC had a $1.8 billion deficit as of Sept. 30, reflecting partial bookings of probable losses from Pan Am.

The PBGC hopes to use some of Pan Am's assets to offset the carrier's $840 million unfunded pension liability.

Jeff Kreindler, a Pan Am spokesman, declined to comment as to whether the company's three pension plans would be terminated. He denied, however, Pan Am has stated it is pursuing an orderly liquidation.

The question for the PBGC is how much it will be able to recover from Pan Am's dwindling estate. Right now, the fight is centered on who will get top claim to assets of Pan Am Shuttle Inc., in a situation that pits the agency against Delta Air Lines Inc., Atlanta.

Delta has offered to purchase the shuttle, certain Pan Am international routes and aircraft for $260 million.

The PBGC holds all of the shuttle's stock as collateral for a $53 million waiver of Pan Am's 1989 pension contributions. That won't present a problem because that obligation will be paid when a sale is consummated.

The key issue stems from the residual value of the shuttle, which is a separate legal entity from the airline. The PBGC plans to file a contingent unsecured claim against the shuttle. Unlike other creditors, the PBGC can pursue joint and several liability claims against all companies commonly controlled by a company whose pension plans are underfunded.

Part of that claim will have priority status, reflecting unpaid pension contributions, and will aid the agency in offsetting the plans' unfunded liabilities.

But Delta wants to insert itself ahead of the PBGC in the creditors' line for the shuttle in exchange for providing Pan Am

See **Pan Am** *on page 39*

Insurer's plight has sponsors on guard

By Hillary Durgin

Pension fund investors, fearful the "run on the bank" experienced by Mutual Benefit Life Insurance Co. could be repeated at other carriers, are likely to revaluate insurance company investments, pension consultants said.

Massive withdrawals by policyholders of Mutual Benefit, Newark, N.J., triggered by concerns over the company's troubled real estate investments, drove the insurer to seek protection against insolvency from the New Jersey State Department of Insurance last week. A New Jersey Superior Court judge placed the company under state rehabilitation July 17.

"The run-on-the-bank phenomenon is really becoming a dominant concern whenever investors get a sense that a company's assets may be vulnerable," said Kim McCarrel, consultant with Wyatt Asset Services, Portland, Ore. "What we're seeing here is a fair erosion of confidence in the insurance industry."

Wyatt had "several clients" that placed contracts with Mutual Benefit in December and January, she said.

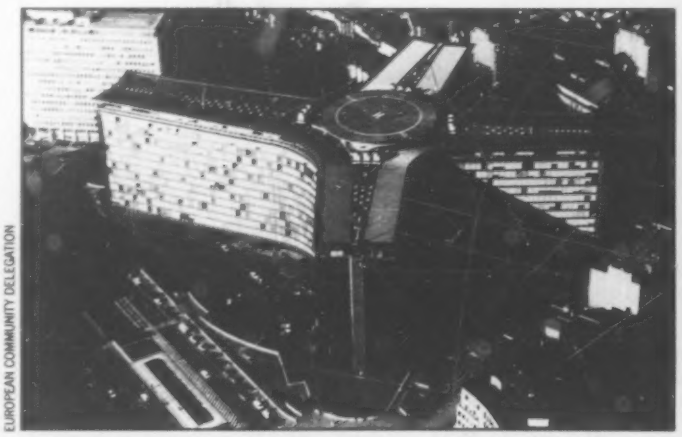
The fear of this nascent phenomenon occurring at other carriers has exacerbated pension executives' concerns over the safety of investments in insurance industry-backed annuities and guaranteed investment contracts, consultants said.

"The greater applicability of 'run-on-the-bank' risk makes an emphasis on quality and industry diversification more applicable than before," said William D. Templeton, director of insurance consulting in the Atlanta office of TPF&C, a Towers Perrin company.

The concern over insurer solvency that began with carriers' junk bond investments — highlighted by the collapse of Executive Life Insurance Co., Los Angeles — is now centering on the industry's troubled real estate holdings, spotlighted by problems at insurers including Mutual Benefit, said Thomas H. Borman, former commissioner of commerce for the state of Minnesota, at a House Energy and Commerce subcommittee hearing last week.

"We are not only witnessing a rapid and sustained rise in the default rate, but we also are reaching a level of distress in insurers'

See **Insurers** *on page 39*



EUROPEAN COMMUNITY DELEGATION

A proposal of the European Commission, whose headquarters is shown above, could lead to pan-European pension funds.

European changes

Directive would liberalize investments

By Margaret Price

As early as this week, the European Commission is expected to take steps leading to greater investment freedom for European pension funds and ignite a process that eventually could lead to pan-European pension funds.

Pensions & Investments has obtained a copy of a proposed European Community draft directive on European pensions. The draft calls for broad liberalizations on two main fronts: freedom of cross-border investing within the European Community and freedom of cross-border pension fund management.

The provisions would apply only to governmental decrees and not to the investment programs of

See **Freedom** *on page 33*

NEWS DIGEST

MICHAEL J. CLOWES

The Kremlin in Moscow is the focal point of radical change in the Soviet Union. *P&I* Editor Michael Clowes recently was part of a group exploring U.S.S.R. investment opportunities. Page 27.

SPECIAL REPORT: EMPLOYEE BENEFITS

Attempts to trim retiree health costs are leading corporate executives to review their overall benefit packages. *P&I* examines this and other issues. Page 19.

FINANCING

Time Warner's revised proposal to issue stock rights hasn't derailed the suit of three pension funds. Page 37.

INTERNATIONAL

The European Commission may soon liberalize pension fund investing. Page 1.

Institutional investors have discovered the Latin American debt market. Page 8.

REAL ESTATE

AMR and 13 others sign up for GE Investments' second realty partnership. Page 2.

The Core Group Trust, a co-investment vehicle, buys into a mall complex in Pentagon City, Va. Page 3.

DEPARTMENTS

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Master trust survey under way

Questionnaires for *Pensions & Investments*' annual survey of the largest master trust, master custody and global custody banks have been mailed. The completed forms, to be used for a special report published Oct. 14, must be returned by Aug. 15. If you have not received a questionnaire, or if you have any questions, contact Christine Philip, directory coordinator, at (312) 649-5217.

GE brings realty to light

Partnership nets $276 million despite difficult market

By Steve Hemmerick

STAMFORD, Conn. — GE Investments has persuaded 14 pension plans to invest $276 million in its new commingled real estate fund in a real estate market where it is difficult to get new investors.

The contributions to the GE Investment Realty Partners II fund came partly as a result of the decision by the pension fund of the money manager's parent, General Electric Co., to invest in the fund, according to Geoffrey Norman, executive vice president with GE Investments.

He said the amount the GE fund contributed is "substantial," but he wouldn't disclose the amount.

With its own or a parent's contribution to invest, some pension executives — stung by poor-performing commingled funds — believe the manager will act more prudently, investing with regard to future performance rather than racking up acquisition or management fees.

"We just think their interest is more in line with ours as an investor because they have their own money in it," said William Quinn, president of AMR Investment Services, Fort Worth, Texas, the in-house investment subsidiary that oversees American Airlines Inc.'s employee benefit funds. The airline's $2.5 billion defined contribution plan contributed about $10 million to the GE Investments fun

"They (GE Investments) are in it as an investment as well as a fee. We think people raise funds and go out and make transactions whether they make sense or not if they are in it only on a fee basis," said Mr. Quinn.

Among the 14 pension or en-

See **GE** *on page 39*

TOM REED

William Quinn likes the fact GE Investments' parent also is investing in the partnership.

Warburg gains in rights deal

By Marlene Givant Star

LONDON — U.S. venture capitalist E.M. Warburg, Pincus & Co. Inc. has more than doubled its stake in Britain's Aegis Group PLC in a transaction that worked within the United Kingdom's preemption rights framework.

The Aegis stake is Warburg, Pincus' biggest investment outside the United States.

Pre-emption stock rights provisions in many countries require a company that sells more than a certain amount of additional stock for cash to make the stock available to existing shareholders first, on a pro-rata basis, before it sells to the public.

Although such offerings usually are done at a discount to the market share price, Warburg, Pincus paid a premium. The structure also was unusual in that warrants were attached.

"The rights problem is difficult for would-be investors like venture capital firms," said Jonathan Brown, vice president of Salomon Brothers International Ltd., London, the adviser to Aegis.

"It was a fantastic deal for the company. One share and one warrant were sold for (about $4.24) while the current share price was (about $3.14 the day before the transaction)," he said.

The deal also was noteworthy for Aegis' use of a U.S. investment bank. Salomon has been the company's adviser for over two years.

The deal took the form of an issue of units, each consisting of one new ordinary share of Aegis and one warrant to subscribe for a further new ordinary share. The warrants have a seven-year life and will be exercisable at any time at a price of about $5.13.

In keeping with U.K. pre-emption rules, Aegis had to offer shares to other stockholders on a pro rata basis. But because of the premium and the unfamiliarity of many U.K. investors with warrants, only 2.4% of shareholders subscribed to the issue, allowing Warburg, Pincus to more than double its stake in the company at a set price.

The key reason the venture capital firm chose this route was to avoid the possibility of having to pay high prices to accumulate a large stake on the open market, which would have inflated the price.

The stock market hasn't been as bullish on Aegis as is Warburg, Pincus. Aegis, a media-buying holding company, has been painted with the same broad brush as the out-of-favor advertising sector, said Mr. Brown.

Thomas Daly, a spokesman for

See **Aegis** *on page 38*

Stanford realigns operations

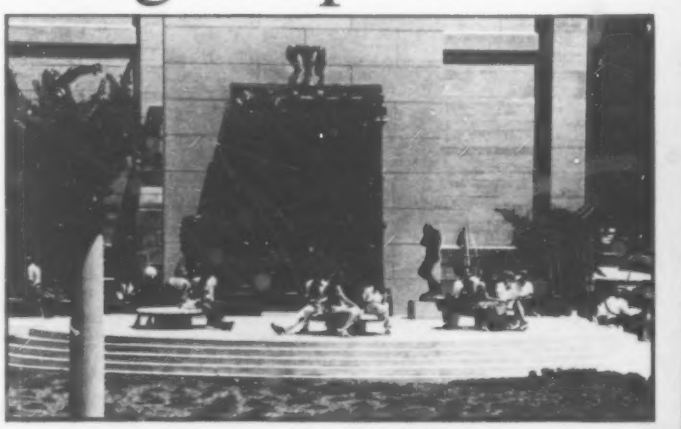
School establishes management firm

By Steve Hemmerick

STANFORD, Calif. — Stanford University has established a new investment management company and shifted key functions of the treasurer's office to it in a major financial reorganization.

Laurance R. Hoagland Jr. has been named president and chief executive officer of Stanford Management Co. Stanford Management has assumed investment management responsibility for $3.6 billion in university assets from its treasurer's office and two real estate groups, including the university's $1.9 billion endowment.

According to university officials, the new management company will be able to pounce on investment opportunities and bring more depth and expertise to financial strategies than under the previous structure.



Stanford University is following the path of other top schools with the establishment of its investment management subsidiary.

Stanford has joined other major universities that have set up management organizations in past years, such as Harvard, Yale and Princeton.

Stanford Management "will position Stanford for the investment climate of the 1990s, which requires more depth of expertise and the ability to move quickly as (investment) opportunities arise," said William F. Massy, director of Stanford's Institute for Higher

See **Stanford** *on page 39*

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HONG KONG LONDON SAN FRANCISCO SINGAPORE SYDNEY TOKYO

Matrix founders off to set up own firm

By Marlene Givant Star

GREENWICH, Conn. — The two founders of Matrix Capital Management have left to set up their own shop.

Matrix, a subsidiary of the Prudential Insurance Co. of America, was founded in December 1985 and manages $650 million for 18 U.S. tax-exempt clients in quantitative equity, fixed-income and tactical asset allocation techniques.

Michael Petrino, president, and Hugh Neuburger, managing director, departed to form a new firm, which might be backed by a domestic or foreign partner. E. Clarissa Moore, marketing director, left with them.

Mr. Petrino said the new firm will focus on global and domestic tactical asset allocation with a special emphasis on implementation using derivatives. In addition to U.S. tax-exempt clients, it would target foreign investors, and will use new futures-related products geared to pension fund clients.

"When you work for a large insurance company as a subsidiary, they own it and can run it anyway they want. That's fair. We built it and grew it to a fairly good-size company. It was a worthwhile experience for us. We want to strike off in different directions," Mr. Petrino said.

Matrix officials say the firm's investment process won't suffer as a result of the defections.

Douglas Love, managing director in charge of fixed income, options and futures, who joined the firm more than two years ago from BEA Associates, New York, said: "Being a quantitative firm, the processes rely heavily on computer-based systems. Those are all in place and being operated by people who operated them all along on a day-to-day basis."

"Although administration and marketing were somewhat specialized within the firm, investment activities were and are run on a very collegial basis, so it's not as if there was a lot of senior/junior vertical decision-making on the investment side . . ."

Harry Knapp, president of Prudential Affiliated Investors, the holding company that oversees nine competing investment management subsidiaries of the insurer, has been named interim chief executive officer of Matrix.

Mr. Love will continue to head fixed income. Randy Hood will remain director-asset allocation; David Sheridan will remain director-equity management. Matrix plans to add at least one investment professional in light of the departures. ■

CORRECTIONS & CLARIFICATIONS

● A table on Page 8 of the July 8 issue incorrectly implied a surge in mortgage defaults at **UNUM Life Insurance Co.** The apparent change was caused by a realignment of UNUM's corporate structure in 1990 that reduced UNUM Life's surplus by 65%. In May 1991, $75 million in additional capital was transferred to UNUM Life by its parent, UNUM Corp., and UNUM Life Insurance of America.

● **John M. Deignan**, head of United States Trust Co.'s institutional asset services and securities services and trust operations divisions, has been promoted to executive vice president. His position was misreported July 8.

● **Quaker Capital Management**'s PIPER+ balanced fund was omitted from the PIPER returns in the May 27 issue. The fund returned 26.8% for the quarter ended March 31; 29.2% for one year; and a compound annual 16.2% for five years, which would have placed it in the first decile for those time periods.

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MARY HERLEHY

Chicago municipal workers could be among those affected by the IRS rules on benefits standards.

IRS rules ruffle public funds

Officials say setting benefits standards is overstepping law

By Ellen Perlman and Trudy Ring

WASHINGTON — IRS rules setting benefit standards for state and local retirement systems — estimated to cost more than $4 billion over the next five years — have incensed officials of those systems.

The Internal Revenue Service rules implement a provision of the 1990 Omnibus Budget Reconciliation Act, requiring that public employees, including many part-time or temporary workers, be covered either by an employer's pension plan or Social Security.

State and local officials, however, say the rules have gone beyond Congress' intent in OBRA in that they not only would mandate benefits but would set standards those benefits must meet.

"The IRS says although you have a qualified retirement system, we're going to set benefits for the state, overstepping states' rights to set up a retirement plan," said Richard E. Schumacher, executive director of the Ohio Public Employees' Retirement System, Columbus. "They're saying if you don't have a certain kind of plan, you have to use ours. It becomes a very volatile issue."

"We truly feel that's not what Congress intended," said Cathie Eitelberg, director of the pensions and benefits program of the Government Finance Officers Association. There is a move afoot in Congress to introduce legislation to clarify the law's intent, she said.

The IRS released the final rules June 28. Plans that already were in existence when the law passed have until Jan. 1, 1993, to comply; newer plans have to comply by Jan. 1, 1992.

When OBRA was passed, Congress estimated the benefits provision would cost states and municipalities $4 billion during the next five years. Ms. Eitelberg said that figure was based only on bringing employees not now covered by a retirement program 5into either an employer-sponsored plan or Social Security, not on having to add Social Security coverage for people already covered by a plan that does not meet

See **IRS** *on page 38*

Equity indexing gains continue

International, domestic still ride high

By Fred Williams

Despite claims by some that it has peaked, index fund investing in all market segments continued to show strong gains for the six months ended May 31.

Once again equity indexing — both international and domestic — showed the strongest overall gains.

International equity indexed assets were up 35.6% for the period to $32.224 billion from $23.762 billion in December, 1990. Adjusted for the 11.6% increase in the Morgan Stanley Capital International Europe Australia Far East Index, international equity indexing was up an impressive 21.5% for the six-month period.

Domestic equity index fund assets jumped 30.2% to $224.953 billion during the period, from $172.726 billion. That represents only a 5.8% increase when adjusted for the 23.12% increase in the Standard & Poor's 500 Stock Index.

On the fixed-income side, domestic fixed-income assets increased 12.5% to $83.519 billion from $74.263 billion. When adjusted for the Shearson Lehman Brothers Government/Corporate Bond Index's 5.94% gain, domestic fixed-income indexed assets grew 6.2%.

International fixed-income funds increased by 10.3% to $1.338 billion, a market-adjusted 9% increase from $1.213 billion in December. The Salomon Brothers World Government Bond Index was up a scant 1.19% for the period.

The total index fund assets of 53 leading index managers surveyed by *Pensions & Investments* was $342.034 billion on May 31, up 25.8% from $271.964 billion reported Dec. 1.

Wells Fargo Nikko Investment Advisors, San Francisco, remains the largest index manager and is approaching $100 billion in assets under management in index funds. As of May 31, Wells Fargo Nikko had $99.855 billion in indexed assets under management.

Indexing, at least on the equity side, will remain a growth industry for the foreseeable future, said Tim Barron, consultant with The Wyatt Co., Cleveland.

"The line between indexing and active management is getting less distinct," he said. "An index (fund manager) buys 500 stocks for full replication, but what about funds with a statistical sampling of 200 or 300 stocks. The line gets hazy. Given that, indexing is not only here to stay but is a growth business."

The line also is blurred in the fixed-income area, he said.

"I've seen a lot of focus on the use of fixed-income indexes, but with fixed income you can usually make a few adjustments and give yourself some over the index."

"My prediction is that bond indexing is not a growth business, but index-plus or enhanced indexes may be in for further growth," he said.

Another attractive feature about indexing, he said, is its low cost, which has now become "almost commodity-like."

John Meneghetti, vice president and manager of quantitative services at NCNB-Texas, said part of the reason for the strong surge in indexed assets during the period may be market related.

"Last year about three out of four managers underperformed the S&P 500 and if plan sponsor decisions were being looked at toward the end of the year, I can see where some changes may have

See **Indexing** *on page 37*

Investors discover Latin debt market

By Marlene Givant Star

The Latin American debt market has been like a party without many guests.

"It's odd that it's such a huge market, yet most people don't know it exists," said Kieran P. Donnelly, head of Latin American investments of Deltec Securities Corp., New York, noting the Latin debt market's 1990 trading volume was $100 billion.

But institutional investors now are streaming into the huge market, attracted mainly to high-yielding, U.S. government-collateralized Brady bonds.

Farmers Group, Los Angeles; Trust Co. of the West, Los Angeles; Magten Asset Management, New York; and Deltec Securities are among the institutions investing in the market. Baker Nye Investments, a New York arbitrage and special situations manager, is researching Latin debt opportunities.

In the past two years, the few professional money managers that have gone "party hopping" among Latin debt markets have enjoyed the festivities, chalking up compound annualized returns of more than 20% by acquiring sovereign and corporate bank loans and equities in countries considered likely to restructure under a Brady plan, and awaiting potentially significant capital appreciation if and when a plan is adopted.

Treasury Secretary Nicholas Brady's plan to deal with the Third World debt crisis calls for a partial forgiveness of principal and a reduction of interest. So far, Mexico, Venezuela and Costa Rica have had their bank debt restructured through Brady plans, with most of the five-year bank debt exchanged for new, longer-dated publicly traded Eurobonds.

In Mexico's plan, the model for the others, the bonds were collateralized by U.S. government zero-coupon bonds with the added protection of 18 months of interest guaranteed on a rolling basis through assets held by the collateralizing agent, payable if the government defaults.

Nigeria, Poland, Brazil, Argentina, Morocco, the Philippines and Equador are viewed by market participants as Brady plan candidates.

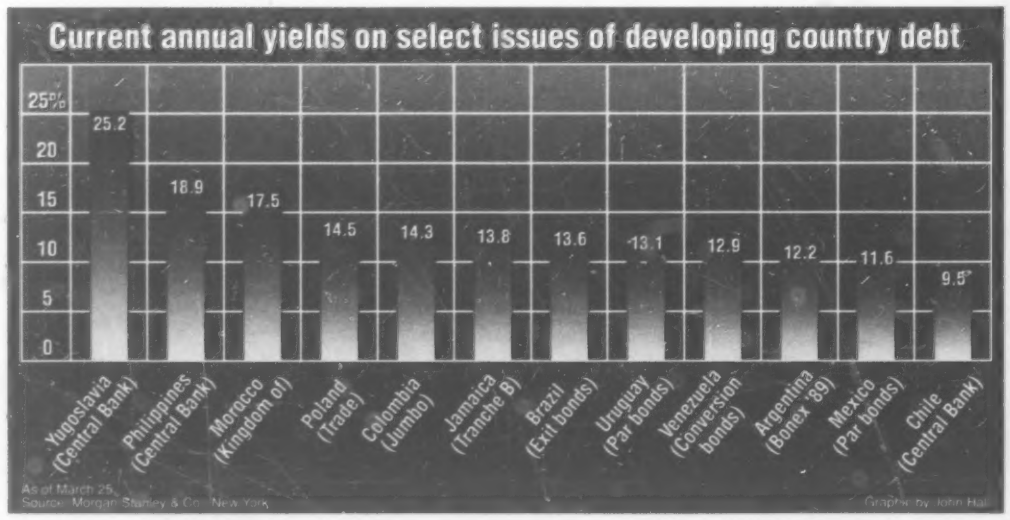
"The time to do it is now because once a Brady plan is done, the bonds go up to a point where they don't have the same sort of appeal. Now there's a yield and capital gain play. Later on, it becomes a pure yield play," said Arthur Byrnes, chairman of Deltec, which manages $100 million in Latin American paper, of which 65% is for clients.

"Typically we expect to realize 50% returns in our corporate and sovereign debt restructurings," said Jerry Finneran, president of TCW Americas, a Latin debt fund operated by Trust Co. of the West.

Several funds geared to institutional investors have been or will be launched in coming months.

Morgan Stanley & Co., New York, expects to raise $100 million in the first closing of a Latin debt limited partnership by the

See **Debt** *on page 36*



REAL ESTATE

Double whammy pulls down investments by Japanese

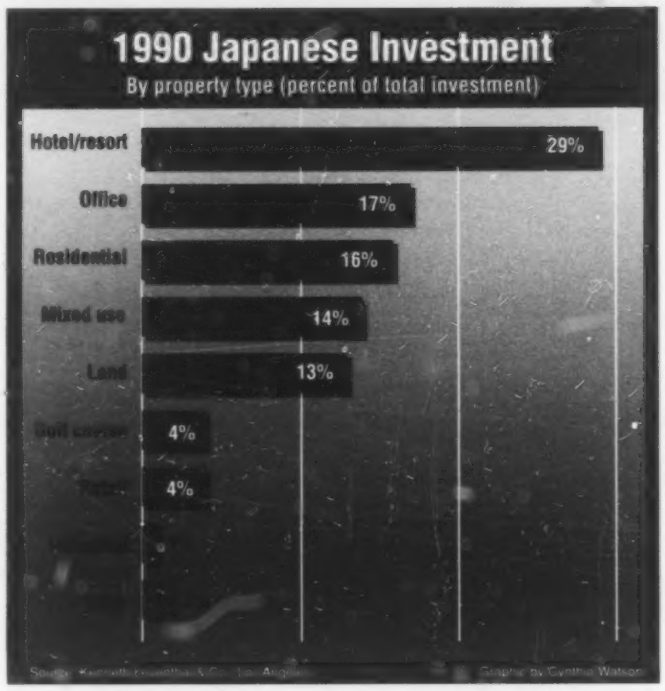
■ Japanese investment in U.S. real estate decreased 12% in 1990, to $13.06 billion from $14.77 billion in 1989, a report by Kenneth Leventhal & Co. shows.

Jack Rodman, a managing partner and director of Leventhal's Pacific Rim activities, said the recession and weak real estate markets in the United States were among the reasons for the decline. Japanese property values, meanwhile, leveled off.

Of the $13.06 billion, the largest share of Japanese money — 29% — was invested in U.S. hotels and resorts, for the second year in a row. Hawaii's share declined, to 28% from 46% in 1989. California and Guam, a U.S. territory, each accounted for about one-fifth of the Japanese investments in that asset class.

Residential properties, especially in California, "will attract the most interest among Japanese investors" this year, said Jack Barthell, a partner in Leventhal's Los Angeles office. That's because residential development creates opportunities to realize high returns in a relatively short time when compared with commercial development, he said.

Full ownership — as opposed to joint ventures — accounted for the majority (57%) of Japanese investments for the first time in 1990, while investments in new construction increased and those in existing properties decreased. Those changes reflect the greater knowledge and comfort level Japanese investors have acquired about U.S. real estate and the development cycle, Mr. Rodman said.



FINANCING

French bank takes a U.S. partner

■ NEW YORK — Societe Generale, France's largest private sector bank, and The Lodestar Group, an investment banking boutique, have entered into a strategic partnership specializing in corporate finance advisory work.

Subject to approval of the Federal Reserve Board, Societe Generale will make an investment in the partnership.

Yamaichi Securities also is a minority investor in Lodestar.

The venture will emphasize mergers, acquisitions, divestitures, joint ventures and financial restructuring.

Lodestar and Societe Generale teams are working together on two cross-border transactions. In the future, Lodestar will employ Societe Generale professionals to work on behalf of clients in Lodestar's New York offices.

Societe Generale has a team of 22 mergers and acquisitions professionals in Paris, Frankfurt and London and plans to open offices in Spain and Italy.

FOUNDATIONS

CFO starts own management firm

■ Gary M. Thomas, chief financial officer for the $260 million Wesley Foundation, Wichita, Kan., has formed his own investment management firm — Prestwick Associates Inc., also in Wichita.

Mr. Thomas will continue to manage $42 million of the fund's assets that had been managed internally and supervise its five outside managers.

The foundation has gone through what Mr. Thomas referred to as a "major restructuring," re-evaluating its investment policies. "They have changed from generalists to specialists," he said.

The foundation's latest tactical move was in its 1-year-old, internally managed $14 million Asset Allocation Fund or "swing fund." The assets are actively managed and rotate among value, growth and large- and small-capitalization stocks, adjusting to perceived risk factors. In March assets were committed heavily to small-cap growth stocks, but most recently the fund shifted into 100% cash because of what is perceived as high risk in the market.

The new firm has several other clients, including institutions, which Mr. Thomas declined to name.

Mr. Thomas' brother, Kent R. Thomas, has joined the firm as a consultant.

Gary M. Thomas

INTERNATIONAL

Roll of dice on German real estate

■ Controls on German property development and mortgage financing could help investors there avoid the fall in property values that plague investors in U.S. properties.

The controls in Germany should support property values and rents during the 1990s, according to a report on the German real estate market by Salomon Brothers Inc., New York.

But David J. Kostin, a Salomon vice president and author of the report, said Germany also faces potentially serious obstacles not found in the U.S. market.

While Germany has been identified as the gateway to the Eastern Bloc economies, there are uncertainties surrounding "glasnost" and "perestroika" that raise questions about the economic viability and political future of the Soviet Union.

Another potential problem is that German unification requires massive public sector borrowing. But the Bundesbank has raised interest rates, which could limit future growth.

There also is uncertainty about the legal basis of property rights in East Germany.

COURTS

Chevron settles lawsuit over surplus assets

■ Chevron Corp., San Francisco, has agreed to pay $245 million to beneficiaries of former Gulf Oil Corp. defined benefit pension plans to settle a lengthy dispute over the ownership of hundreds of millions of dollars in surplus assets held by two overfunded Gulf plans.

The settlement was reached in late June, following an April ruling by a U.S. District Court judge in Houston.

The April judicial ruling had awarded plan participants the $190 million in surplus held by the two plans.

The judge had ruled the wording in the plan documents indicated Gulf Oil had intended any surplus assets to be distributed to plan participants.

Chevron had said it would appeal that ruling.

Under the settlement, the 19,000 plan participants will receive $150 million in accrued benefits in a lump sum, plus half — or about $95 million — of the surplus.

Chevron, which acquired Gulf in 1984, will retain the other $95 million.

Not affected by the settlement is another portion of the April ruling that held Chevron is entitled to $620 million in surplus assets contained in another Gulf pension plan.

That plan made it clear any surplus assets would revert to the employer, the U.S. District Court ruled.

The participants in the plan are contesting that portion of the ruling.

Attorneys for the employees could not be reached.

WASHINGTON

Congressmen put ESOPs on agenda

■ A band of 36 congressmen is working to regenerate grass-roots support for employee stock ownership.

Rep. Beryl F. Anthony Jr., D-Ark., introduced the ESOP Promotion and Improvement Act of 1991, H.R. 2410. A comprehensive bill, it would give company employees an 80-day window period to form an ESOP in response to a foreign takeover offer. Reps. Dana Rohrabacher, R-Calif., and Cass Ballenger, R-N.C. are leading cosponsors of the legislation, introduced May 21.

Rep. Beryl F. Anthony Jr. has introduced an ESOP bill.

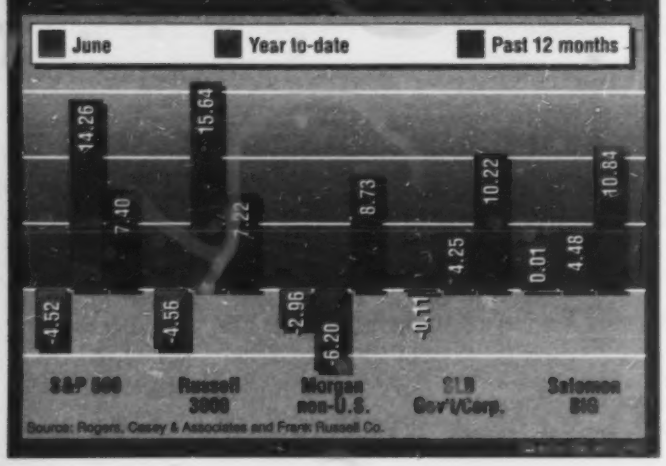
"There is ample evidence, especially in the past five years, that employees can benefit greatly in financial terms by having an ownership stake in their corporation, and that an ownership culture among employees can greatly enhance the overall quality of work and competitiveness of the corporation with employee ownership," Rep. Anthony told members of Congress when he introduced the bill.

The bill also affirms the legality of arrangements that combine ESOPs with 401(k) plans. The Internal Revenue Service is studying issues of non-discrimination testing and the use of employer or employee contributions to repay leveraged ESOP loans in conjunction with these types of plans.

The legislation also would extend ESOPs to Subchapter S corporations, chartered corporations with 35 or fewer shareholders that are taxed as partnerships. These corporations comprise nearly one-third of all companies in America, Rep. Anthony said.

Pensions & Investments' indexes

The P&I monthly indexes track changes in the Standard & Poor's 500 Stock Index, Frank Russell Co.'s Russell 3000 Stock Index, the J.P. Morgan non-U.S. Government Bond Index, the Shearson Lehman Brothers Government Corporate Bond Index and the Salomon Brothers Broad Investment Grade Bond Index.



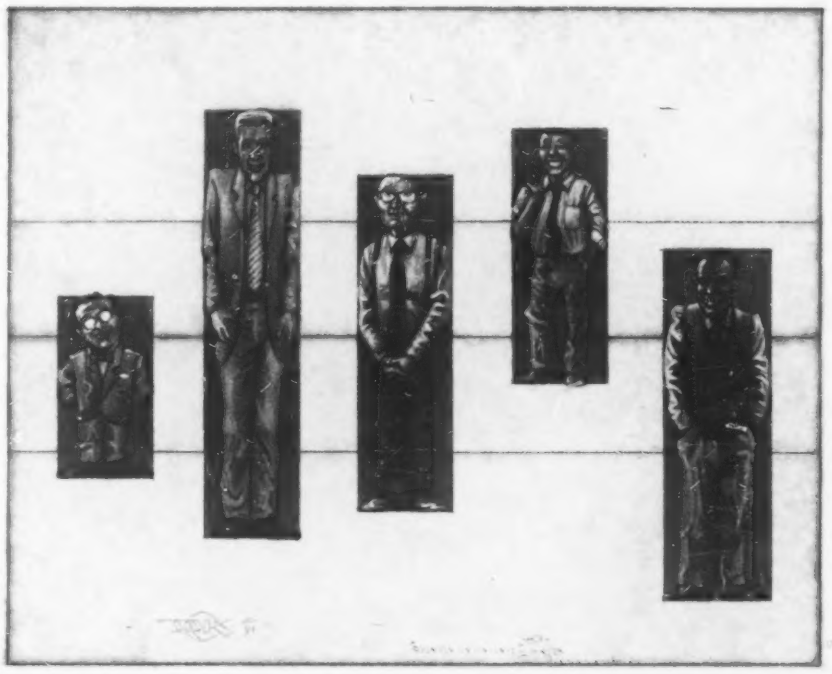
Flaw of using 'median manager' as benchmark

In terms of performance evaluation, perhaps the most widely used benchmark, aside from market portfolios like the Standard & Poor's 500 Stock Index, is the "median manager." Taken from a universe of managers, the median manager benchmark has a certain naive appeal. The conventional wisdom expects that a superior manager will outperform the median manager over, say, a three- or five-year evaluation period. But is the median manager an acceptable benchmark?

Proponents of the median manager benchmark never have presented evidence supporting its validity. The validity has always been asserted, not demonstrated.

Many pension fund sponsors, consultants and managers use the median manager from a universe of managers. These manager universes are easy to construct and maintain. But are they useful?

To evaluate the median manager benchmark, we applied a set of benchmark quality measures we've developed. A well-known universe comparison service supplied us with data on the performance of the median performing manager in the growth manager segment of the universe. (This universe comparison service, we point out, segments its equity manager universe in response to concerns that a manager universe incorporating a broad group of equity managers wasn't sufficiently representative of different manager investment styles. Consequently, if we find the median style manager benchmark wanting, that criticism will apply even more strongly to other manager universes that don't segment styles.)



DOUGLAS KLAUBA

Jeffrey V. Bailey, David E. Tierney and Thomas M. Richards, principals at Richards & Tierney Inc., Chicago, wrote this commentary. Their study "Evaluating Benchmark Quality" expands on this analysis.

For our study, we used the returns for a well-known manager who is universally classified as a large-capitalization growth manager. Thus, there should be no question concerning the comparability of this manager's performance against the median growth manager.

Immediately we encountered problems. Like all users of manager universes, we have no access to the composition of the median manager's portfolio and have unanswered questions. Is there any correspondence between the securities in which our large-cap growth manager invests and the area of expertise represented by the median manager benchmark? Could our large-cap manager actually invest in the median manager's portfolio? Is there any similarity in the risk exposure of our large-cap manager and the median manager?

The inability to examine the composition of the median manager's portfolio eliminates any use of that benchmark in total portfolio risk control. It undermines the benchmark as a performance evaluation tool. The median manager benchmark is an investment apparition; the only trace of its existence is its reported returns.

We can apply to the median manager only the three benchmark quality measures that involve returns. These measures relate to evaluation "noise," investment style and value-added. To explain, we begin with three return series for 1) the manager's actual portfolio 2) the median manager and 3) the S&P 500. The results cast a poor light on the median manager benchmark.

With respect to the first measure, we believe a good benchmark should reduce evaluation "noise." To understand, consider a manager with perfect foresight. Every month the manager outperforms the benchmark by 0.25%. By definition, the standard deviation of the manager's value-added performance is zero. In this case there is no evaluation "noise." That, however, is not the real world. There will be a period-to-period variation in a manger's value-added performance. However, we believe, the better the benchmark, the lower will be the period-to-period variation.

Period-to-period variation can be measured by standard deviation. In the case of the median manager, the standard deviation of the manager's performance vs. the median manager benchmark was 8.1% per annum. By comparison, the standard deviation of the differences between the manager and the S&P 500 was 7.6% per annum. The median manager, selected from a growth stock manager universe, did not reduce any evaluation "noise." Rather, it obscured the manager's investment skill.

As mentioned, the second measure relates to a manager's investment style. Again, we consider the three return series. Each time period, we calculate two return differentials. The first is the excess return difference between the manager's actual return and the S&P 500. The second is the excess return difference between the median-manager benchmark and the market. Since we now have two return differentials for each time period and also a number of time periods, we can calculate a correlation coefficient.

A good benchmark will result in a high, positive correlation coefficient. That is, when a manager's style is in favor we expect both the portfolio and the benchmark to outperform the market. Alternatively, when out of favor, both can be expected to underperform. Using the median manager as a benchmark results in a correlation coefficient of 0.297 which is only slightly greater than zero. As an aside, we believe a good benchmark will have an excess return correlation coefficient of 0.5 or greater.

The third quality measure involves the pattern of a manager's value-added performance. We believe managers do not become instantaneously smart or dumb. It is a continuous process. A good benchmark will reveal the "goodness" of a manager's investment process regardless of the market environment.

To address this issue, we again calculate a correlation coefficient of return differentials. One input is the excess return difference between the median-manager benchmark's return and the market return. This can be considered to be the investment style return. The other input is the value-added return, which is the difference between the manager's actual portfolio excess return and the median-manager benchmark's excess return. We believe the correlation of these two return differentials should be close to zero. Anything significantly different suggests the manager's value-added capability was related to the market environment and whether the manager's investment style was in or out of favor.

In our case of the growth manager vs. the median manager as the benchmark, the correlation coefficient was −0.450. Obviously, the correlation is different from zero. It suggests the manager will look good when the median growth stock manager underperforms the market and vice versa.

In short, we fail to find any evidence the median growth manager is an acceptable benchmark for our growth manager. We strongly suspect these results would apply as well to other median manger benchmarks taken from other manager universes.

The median manager benchmark violates virtually all of the fundamental properties of a valid benchmark in the sense it is ambiguous, uninvestible and not specified in advance. In addition, the median manager benchmark has severe survivor biases. Our evidence shows the median manager benchmark fails to pass a series of reasonable benchmark quality tests. We believe those practitioners who have so uncritically employed the median manager benchmark in performance evaluation should reconsider their advocacy. ■

LETTERS TO THE EDITOR

Oh, not those total assets

■ Somehow, we got some wrong numbers to you that appear in the May 20 issue, profiling money managers.

The table on page 3 lists Banc One Corp. as having $44 billion under trust management. That is the corporation's total assets. The number should have been $13.6 billion. My concern is not that a correction be run, but that next year when growth numbers are computed that they are based on the proper number. Otherwise, the statistics will show a dramatic drop (assuming we get the right number to you for 1992).

John A. Russell
Vice president
Director of communications
Banc One Corp.
Columbus, Ohio

No balanced, no TAA

■ The description for our firm in the May 20 issue is incorrect.

Burgess Capital doesn't offer a balanced product. We do currently manage a balanced account, but this is not an offered product.

Also, Burgess Capital also does not use tactical asset allocation.

Christine C. Mangan
Vice president
Burgess Capital Corp.
Redwood City, Calif.

Adding international equity

■ Two corrections are necessary for the profile of Loomis, Sayles & Co. on page 56 of the May 20 issue.

First, the description should be: Loomis, Sayles & Co. is an active domestic *and international* equity . . . manager.

Second, the client contact is myself.

Douglas R. Nelson
Managing partner
Loomis, Sayles & Co.
Pasadena, Calif.

A change in numbers

■ I am writing to correct some of the statistics in the profile of Princeton Bank and Trust Co. in your May 20 directory of investment advisers.

Its total assets under management as of Jan. 1 were $1.542 billion, of which $1.359 billion were discretionary. Total tax-exempt assets managed were $301 million, of which $256 million were discretionary. The firm had $60 million in 401(k)/457 assets. The asset mix Jan. 1 was 40% stocks, 50% bonds and 10% cash.

Joseph E. Serzan
Vice president-institutional services
Princeton Bank and Trust Co.
East Brunswick, N.J.

A fuller description

■ The description of the investment style in the May 20 profile of HD International omits several points and gives an erroneous view of our firm. The description should have read:

The firm, an international/global equity manager, uses an active top-down approach emphasizing growth with strict valuation disciplines. Clear definitions of growth are applied to both country and stock selection. Our top-down, rate-of-return forecasts are translated into country allocations resulting in concentrations in a limited number of countries.

In addition, a typographical error has HDI managing $15 billion in international fixed-income assets rather than $15 million.

Francine R. Elster
Vice president
HD International Inc.
New York

Kurtz's better betas

The betas in the July 8 letter from Lloyd Kurtz, senior research analyst with Kinder, Lydenberg, Domini & Co. Inc., Cambridge, Mass., should have been expressed as plain numbers as he correctly did in his correspondence and not as percentages as they were mistakenly published.

Debt

Continued from page 8

end of the month. The fund, geared to foundations, wealthy individuals, insurance companies and portfolio managers, will take positions in bank loans of countries in which it expects a Brady plan. The fund will be able to borrow to a limited extent.

TCW Americas, a $225 million limited partnership of pension funds and other institutions, buys debt of governments and corporations in Latin America. TCW will market two more funds — one for pension funds and one for taxable investors — in the next few weeks, with hopes of raising another $225 million.

Thanks in part to the country's debt restructuring, Mexican companies are now tapping the international capital markets again for the first time in years, mostly with five-year public Eurobond deals.

Other Third World countries are following suit. Deals by the National Bank of Hungary and Venezuela reportedly are in the pipeline.

By converting Latin debt to a form more palatable to investors, the Brady plan has helped narrow spreads in the market by 300 to 400 basis points vs. U.S. Treasuries of comparable maturities during the past six months, according to Michael Marshall, director of corporate bonds at Salomon Brothers Inc., New York. Salomon's asset management subsidiary manages a $74 million Latin debt and equity fund along with BEA Associates, New York.

Brady bonds now yield 11.5% to 14% on a cash flow yield basis, which is still hard to match in other fixed-income instruments, Mr. Marshall said.

Salomon has begun to apply modern portfolio theory to Latin debt markets, which also should stimulate interest from institutions, he said.

"Banks, original lenders and investment banks were the market before institutions started coming in, and they are still the bulk of the market," said Jay Newman, managing director of Morgan Stanley. He estimates 20 to 30 insurers now invest in the market, whereas none did a year ago.

Commercial banks remain the principal dealers in Latin debt because they represent the market's supply.

The predominant investors are expatriates of Third World countries that are re-investing their money now that restructurings are under way, Mr. Marshall said.

The risks of Third World investing are well documented. But investors are only beginning to recognize the U.S. government backing and liquidity of Brady bonds and the size of the market, which did not really develop until around 1984, two years after the debt crisis.

"It's perception and reality. Most people say, 'Who would go into that debt and get into an illiquid kind of holding?' without realizing you can call any bank or investment bank and get a quote within a half point. That's what creates investment opportunities: the perception being quite bad and the reality being much better," said TCW's Mr. Finneran.

Latin equity markets often soar following debt restructurings, he said, noting Venezuela and Mexico are among the five top-performing equity markets in the world.

In most corporate restructurings, investors receive equity participations. The other major opportunity is to anticipate the tremendous amount of momentum a debt restructuring creates as far as an equity market. TCW has its eye on Brazil's depressed stock market.

The most conservative investors — insurance companies and pension funds — are not interested in arbitrage using complicated-to-own bank debt, as much as buying bonds for the pure yield.

Magten is eagerly tapping the Latin debt market and has purchased Polish debt. In a report to clients, Talton R. Embry, managing director and chief investment officer, said: "We believe that the bad loans that were made in 1981 will be recapitalized successfully in the 1990s. We believe this area represents a fantastic opportunity. At the present time, we have purchased the listed bonds of Brazil and the Philippines and have purchased bank loan participations in Argentina. All of these obligations are denominated and payable in U.S. dollars."

The Latin debt market has been largely untapped by investors. From 1982 through 1989 "it's done nothing but gone down, so people were losing money so it wasn't a happy place," Deltec's Mr. Donnelly said. Because individuals can't buy the debt, he said, "there's no retail market, so it's not quoted on exchanges."

After being battered in the period from 1987 to 1989, investors that stuck it out are being richly rewarded, largely thanks to attractive price arbitrage plays and/or high yields.

"Performance has been outstanding in the past six to 12 months. . . . We got in there at a lucky time," said David Iben, director of fixed-income investments of The Farmers Group, which invests a small portion of its $440 million pension fund and its life insurance and property/casualty general accounts in Latin bonds.

A year ago, Farmers invested in — and it still holds — Mexican Brady bonds. It also purchased Venezuelan sovereign bonds as well as one small issue of Mexican bank debt. Recently, it increased its Venezuelan holdings and purchased straight corporate debt of Cemex, the Mexican cement company.

"The yields are obviously good. The diversification makes sense also. The risks are real, so you have to stay diversified," Mr. Iben said.

Baker Nye officials have been looking at bank debt of Argentina and Brazil "given the slowdown in mergers. . . . We only invest in something event-driven, if we see a restructuring we can quantify and get comfortable as to timing," said George Konomos, portfolio manager at the firm, which runs $600 million, about half for pension funds. ■

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Indexing

Continued from page 8

been made and may account for some of the growth," he said. Also, said Mr. Meneghetti, some plan sponsors intentionally seek market-based performance for their 401(k) funds. "Often, they don't like to explain to participants why a fund underperformed the market."

Nick Lopardo, chief investment officer at State Street Bank & Trust Co., Boston, said the growth in international equity indexing is connected with the overall interest in international investments by pension plan sponsors of all sizes.

"The movement to the international arena has led to a whole new area; a natural first step for many is international indexing. We've seen that business grow from $100 million in 1979 to $10.8 billion."

"In the last three to five years, the world has become smaller and the capitalization of the world is moving outside North America. . . . There are tremendous growth opportunities down the road for indexing. We're real bullish about where the market is going," he said.

Mr. Lopardo and others noted the lack of interest in international fixed-income indexing, blaming currency drawbacks and a heightened interest in equity markets both foreign and domestic.

"There have been spurts of activity and interest (in international fixed-income indexing) but very few clients have actually made an investment and pulled the trigger. The market just hasn't moved into international bond funds," said Mr. Lopardo.

He said interest remains high in specialized or extended indexes rather than the "pure" index such as the S&P. He said, for example, State Street developed a "second 500" stock index nearly 18 months ago and plans to convert that to the new S&P Midcap, a new index of medium-capitalization stocks.

"We're seeing a lot of interest in that and will probably enter the market soon with a Russell 2000-like product," Mr. Lopardo said.

Ryan Labs, New York, also has developed a specialized index fund product. The product matches pension liabilities to assets.

"To date there has been little, if anything, regarding having liabilities as an index. The next frontier is to have liabilities as a custom index," said Ron Ryan, president of Ryan Labs.

Mr. Ryan said his firm has developed such a liability index that can be customized to a plan sponsor's liability schedule.

"We price the liabilities daily and create a daily liability index weighted by the actual liability schedule of the plan sponsor. We break it out by duration and manage the assets to duration match the liability index but exceed the return of the liability index. We believe it is the evolution of dedication and immunization," Mr. Ryan said.

"For the first time ever, the plan sponsor knows his liability growth at all times. Traditionally, he only knew his liabilities once a year, three to six months delinquent," he said. ■

Leading index fund managers

($ millions)

Company	Total	Domestic equity	Domestic fixed income	Int'l equity	Int'l fixed income
Wells Fargo Nikko	99,855	63,600	27,000	9,000	255
Bankers Trust	64,143	51,500	8,560	3,760	323
Mellon Capital	32,155	26,270	5,320	565	0
State Street	30,380	17,209	2,167	10,840	164
AMB*	11,607	9,436	1,724	447	0
PanAgora	9,631	5,844	2,483	931	373
Alliance	9,100	8,200	22	878	0
Mellon Bond	7,500	0	7,500	0	0
Lincoln Capital	7,032	0	7,032	0	0
Dimensional Fund	5,885	4,200	876	782	27
Vanguard	5,433	4,703	523	204	0
Wilshire	5,200	5,200	0	0	0
DE Investment	4,945	4,945	0	0	0
T. Rowe Price	3,435	450	2,985	0	0
Chase**	3,130	1,500	530	1,100	0
Manufacturers Nat'l	4,702	4,650	47	5	0
Pacific Investment	4,000	1,100	2,900	0	0
Boston Int'l	1,987	0	0	1,987	0
PDI	1,724	1,528	0	196	0
Travelers	1,715	1,083	249	356	27
Fidelity	1,713	981	732	0	0
Northern Trust	1,702	1,365	337	0	0
Prudential Fixed Income	1,647	0	1,647	0	0
BEA**	1,570	0	1,570	0	0
Pyramis	1,500	0	1,300	0	0
First Wisconsin	1,440	140	1,300	0	0
Advanced Investment	1,423	1,412	11	0	0
Sears	1,300	1,222	0	78	0
Putnam	1,255	0	1,255	0	0
Axe Core	1,208	782	0	426	0
Chancellor Capital	1,179	1,153	0	26	0
Lehman Ark	1,034	0	1,034	0	0
Security Capital	1,150	0	831	0	199
CIGNA	914	879	35	0	0
Mitchell Hutchins	884	118	766	0	0
NCNB-Texas	817	817	0	0	0
Atlantic Portfolio	760	0	760	0	0
Nikko Capital	703	439	0	264	0
ANB Capital	605	605	0	0	0
Aetna Life**	604	490	114	0	0
Bankers	591	576	15	0	0
Capstone	500	500	0	0	0
Wayne Hummer	475	475	0	0	0
Associated Capital	359	282	77	0	0
Old Kent	350	350	0	0	0
Dimensional Asset	334	0	0	334	0
Mercer Capital	331	180	108	43	0
Bear, Stearns	325	0	325	0	0
Scott Investment	254	0	254	0	0
NBD Bancorp	277	277	0	0	0
Rushmore	254	254	0	0	0
Metropolitan Life	209	209	0	0	0
Bell Canada	764	0	764	0	0
TOTAL	342,034	234,915	83,218	35,234	1,339

3 funds won't drop Time Warner suit

By Barry B. Burr

Three public pension funds that sued Time Warner Inc., although happy the company dropped some of the most objectionable features of its original stock rights proposal, are angry it has declined to negotiate some outstanding issues.

The funds, which by suing became part of a groundswell of institutional investor opposition that forced Time Warner to retreat from its original proposal, are keeping active their lawsuit against the company and are annoyed other pension funds refused to join the suit, according to their attorney.

The continuing complaint of the funds — the $22 billion Florida Board of Administration, $2.2 billion Louisiana State Employees' Retirement System and the $3.5 billion Teachers' Retirement System of Louisiana — focuses on two issues unresolved in Time Warner's revised offering:

- Recovery from Time Warner of the some $10.1 million in market losses the three funds have sustained in aggregate on their common and preferred stock in the company from the drop in prices since management initially proposed a rights offering; and
- Failure to extend the stock rights to preferred shares.

"The reason Time Warner revised its offering proposal was because the Securities and Exchange Commission wouldn't approve the prospectus, because major pension funds complained" about the stock rights structure, said I. Walton Bader, partner with Bader & Bader, White Plains, N.Y., and attorney for the three funds.

Time Warner revised the offering, satisfying the SEC, and meanwhile negotiated a settlement in principal with lawyers who had filed class-action cases in Delaware opposing the original offering, involving about a half-dozen cases.

The three funds, the only institutional investors to sue, weren't part of those negotiations.

"If you take all these plaintiffs," Mr. Bader said, referring to the other suits, "I doubt if they have $10,000 in stock." But the suing pension funds have more than $40 million in Time Warner stock, he added.

"This is the stuff that burns the hell out of me," Mr. Bader said, because of Time Warner's failure to negotiate with the funds.

Mr. Bader said he has talked with Arthur Liman, Time Warner's lead counsel, and plans to pursue negotiations.

"We wanted (the California Public Employees Retirement System) to join us, but they wouldn't," Mr. Bader said.

"One of the biggest problems has been the apathy of pension funds to assert their rights," he said.

"If CalPERS had come into this situation we would have had more clout. Maybe Time Warner would have withdrawn their (original) offer earlier" before the price of the stock fell as much as it did, allowing the company to offer a fixed-price rights offering at a higher price than the $80 a share it ultimately has. In addition, he said with California's additional clout, Time Warner might have extended the rights to preferred stock and provided for some monetary damages to the funds, as well as to all shareholders. "People who hold the stock lost a tremendous amount of money," because its price fell precipitously because of the proposal, Mr. Bader said.

The California fund, however, hired an adviser to evaluate the matter, Providence Capital Inc., New York, and through it complained of the initial proposal to Time Warner and the SEC.

"We along with others felt the original offering was coercive and resisted it," said DeWitt Bowman, the fund's chief investment officer. "We're pleased to see Time Warner change it."

The fund "generally supported the aims of the lawsuit" by the three Southern pension funds, he said.

Mr. Bader said Time Warner offered the other plaintiffs a settlement of $2.5 million in fees and costs. The plaintiffs, in turn, offered the suing pension funds a $25,000 share in the settlement.

Mr. Bader said the funds likely would oppose such a settlement with the other plaintiffs, calling them vultures.

"We are concerned with the viability of Time Warner. We don't want to see assets erode, and that includes paying excessive fees to these people."

California's Mr. Bowman said Time Warner's willingness to change the proposal shows the influence of major shareholders on management.

The California fund holds 554,900 shares of Time Warner common stock and 23,226 shares of its Class D preferred stock. Mr. Bowman said the fund would exercise the rights for the 354,700 common shares it holds in internally managed index funds to maintain its weighting. He said its other 200,200 shares are held by active equity managers.

"It's up to their discretion whether to exercise the rights," he added.

If rights were extended to preferred stock, the three litigating funds, which hold in all 545,844 shares of Time Warner Class C and D convertible preferred stock, would have rights worth nearly $4 million, based on the rights trading on a when-issued basis as of July 16 at 7¼ each.

Of the three funds, only the Florida board owns Time Warner common stock, holding 357,000 shares.

Horace Schow II, the Florida board's general counsel, said the fund hadn't decided whether to exercise its rights to buy more stock, but nevertheless valued them because it could sell the rights.

Mr. Schow said the Florida board also has written the investment banks involved in the offering, including lead managers Merrill Lynch & Co. and Salomon Brothers Inc.

Despite the continuing dispute, Mr. Schow said, "We're rather pleased right now," about the influence of shareholders in forcing the change in the offering.

"I think this is even more dramatic than slow-moving proxy contests," he added. "This was dramatic and quick. There was a groundswell against Time Warner management's proposal. But not against the company. We want Time Warner to succeed because we own a lot of it." ■